

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
 , ID No.

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Refer Reply To:
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PLR-106797-11

Date:
August 15, 2011

Legend

City =
Trust =
Plan =
Date 1 =
Date 2 =

Dear :

This is in response to your February 9, 2011 letter and a supplemental submission requesting the following ruling:

Trust's income is excludable from gross income under I.R.C. § 115(1) because Trust's income is derived from the exercise of an essential governmental function and accrues to a state or political subdivision thereof.

Facts and Representations:

Trust was established on Date 1, effective Date 2, by the City Commission. City's Chief Financial Officer serves as Administrator of the Trust and the Trust's Trustee. City has established Health Plans to which retirees of City and of Participating Employers may participate to obtain medical care pursuant to Resolution. Participating Employers are defined as City, a political subdivision, or an entity the income of which is excluded under section 115. Separate accounts or sub-trusts may be maintained in Trust for appropriate categories of retirees of City and of Participating Employers.

Trust is used as a funding vehicle by which the Administrator accepts contributions to the Trust and forwards the contributions to the Custodian for holding and administration. The Administrator is also responsible to credit deposits to appropriate sub-accounts.

The Trustee will invest and reinvest the Trust and pay benefits from Trust at its direction solely to provide medical benefits to Retirees, spouses and dependents of retirees.

Contributions to fund for benefits under the Trust shall be designated by resolution of City or of Participating Employers with the annual amounts determined pursuant to the Resolution.

The Trust provides that in no event will Trust's assets be distributed to or revert to an entity that is not a state, a political subdivision or an entity whose income is excluded under section 115. The Trust is only seeking a ruling with respect to the federal tax treatment of Trust's income.

Plan documents provide eligibility rules and describe individuals eligible to participate in the Plan. Eligible persons include retirees of the City or of Participating Employers, a spouse under a legal existing marriage and a retiree's unmarried dependent children are dependents eligible to participate.

Benefits are paid in accordance with benefit schedules in the Plan's handbook and booklets. Retirees and employees through the Trust share in the cost of the medical coverage under the Plan. Plan provides no cash-out of unused amounts and is not funded by any conversion of sick or vacation days. There is no employee election with respect to any provision so that no employer contributions are made through pre-tax salary reductions.

Law and Analysis:

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to

taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust was established by City, a political subdivision, to enable the pre-funding of health benefits for Retirees, their spouses and eligible dependents and for Retirees, their spouses, and eligible dependents of Participating Employers. Payment of such benefits constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

No private interests participate in or benefit from the operation of Trust. Any distribution of funds in Trust can only be used to pay benefits or revert to City or Participating Employers. The benefit to City, the Participating Employers, or the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by Trust, we hold that the income of Trust is derived from the exercise of an essential government function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no representation is made that contributions or premiums paid on behalf of or benefits received by employees, former employees, retirees, spouses, dependents or others will be tax-free. This ruling concerns only the Federal tax treatment of Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Sylvia F. Hunt
Assistant Branch Chief, Exempt Organizations
Branch (EOEG)
(Tax Exempt & Government Entities)